

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF GASCO DISTRIBUTION)	
SYSTEMS, INC. FOR A CERTIFICATE OF)	
CONVENIENCE AND NECESSITY TO PROVIDE)	CASE NO. 94-427
LOCAL GAS DISTRIBUTION SERVICE TO ALBANY,)	
KY. AND FOR TRANSFER OF THE ALBANY GAS)	
UTILITY COMPANY)	

O R D E R

IT IS ORDERED that Gasco Distribution Systems of Kentucky, Inc. ("Gasco") shall file the original and 10 copies of the following information with the Commission, with a copy to all parties of record within 10 days of the date of this Order. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets is required for an item, each sheet should be appropriately labelled for example, Item 1(a), Sheet 2 of 6.

1. With reference to the Plan of Reorganization submitted with your application, provide the following:

a. An organizational flowchart depicting all divisions and subsidiaries of the parent, The Titan Energy Group.

b. State the purpose of the proposed reorganization.

c. State the impact the reorganization will have on the operations and rates of Gasco of Kentucky.

d. Describe the accounting and reporting system that will be implemented by Gasco to ensure that directly assignable utility and non-utility costs are accounted for properly and that

reports on the utility and non-utility operations are accurately presented.

e. Provide a copy of any policies and/or guidelines that address intercompany transactions.

2. The Holding Company Guidelines¹ attached as Appendix A describe the filing and reporting requirements this Commission has placed on Cinergy Corp. The guidelines are similar to those established for other holding companies that own utilities which are subject to Commission jurisdiction. Review the requirements and provide any comments or concerns the company may have with regard to the applicability of the guidelines to Gasco.

3. With reference to the proposed financing with Enron Financing Corporation ("Enron"), provide the following:

a. An estimate of the expenses that will be incurred in the process of acquiring the loan. This estimate can be presented either in dollars or as a percentage of the loan.

b. Is there a limit to the amount of expense Gasco can incur in acquiring this loan? If yes, state the amount of this limitation.

4. Refer to page 2 of Exhibit A of Gasco's November 23, 1994 motion.

a. Explain what "LIBOR" means on page 2 of Exhibit A of Gasco's motion for expedited treatment.

¹ Case No. 94-104, Application of The Cincinnati Gas & Electric Company and Cinergy Corp. for Approval of the Acquisition of Control of The Union Light, Heat & Power Company by Cinergy Corp., Final Order Dated May 13, 1994.

- b. What is the current LIBOR rate?
- c. How often will the LIBOR rate change?
- d. What is the basis for the "4.5 percent p.a." that will be added to the LIBOR?

5. Refer to the interest rate on page 2 of Exhibit A of Gasco's November 23, 1994 motion.

- a. How was the 75 percent fixed and 25 percent variable interest rate mix determined to be reasonable?
- b. Is the 25 percent variable rate portion of the interest rate convertible to a fixed rate at any time?
- c. Are the percentages to be applied to the outstanding balance quarterly? If not, explain how the percentages will be applied to the debt.

6. Refer to the prepayment provisions provided on page 3 of Exhibit A of Gasco's November 23, 1994 motion.

- a. Describe the purpose of any hedging transactions involved in securing the proposed financing.
- b. Provide copies of any interest rate exchange agreements into which Gasco has entered.

7. Provide a current detailed plant and accumulated depreciation schedule for the Albany Gas system using an original cost valuation.

8. Provide an explanation for the \$65,351 related party accounts payable recorded on the June 30, 1994 Consolidated Balance Sheet included as Exhibit 4 of the application. State whether this liability remains outstanding.

9. Provide the journal entries Gasco will make to record the transfer of the Albany Gas assets.

10. Refer to Note 2 of the Notes to Consolidated Balance Sheets and Income Statements provided as Exhibit 4 of the application. Explain the \$30,000 note payable to Walton Haddix.

11. Refer to Exhibit 5 of the application: Provide all assumptions used in projecting the following:

- a. Trade Accounts Receivable
- b. Trade Accounts Payable
- c. Related Company Payables
- d. all Income Statement accounts.

12. Justify the proposed level of management fees to be incurred by Gasco each year 1994 through 1998.

13. Provide the resumes of Gasco's operators and any information showing their experience in the operation of a gas distribution system.

14. Provide a copy of the Operating and Maintenance Manual for Gasco's system.

15. Refer to Exhibit 2, Rules and Regulations:

a. Sheet No. 2, Paragraph 5 states that Gasco cannot and does not guarantee either a sufficient supply or an adequate or uniform pressure. Explain how no guarantee of a sufficient supply complies with KRS 278.010(12) and KRS 278.030(2); and how no guarantee of an adequate or uniform pressure complies with 807 KAR 5:022, Section 13(14). Refer to any agreements or contracts between Gasco and its gas suppliers which support this statement.

Furthermore, provide the maximum operating pressure in Gasco's system.

b. Sheet No. 3, Paragraph 10. Specify the point of delivery of gas to Gasco's customers.

c. Sheet No. 6. How was the \$95.00 deposit determined?

d. Sheet No. 7, Paragraph 15(4). Explain why Gasco proposes to discontinue service for non-use even when the customer pays the minimum monthly charges.

e. Sheet No. 7, Paragraph 16. Is Gasco aware that 807 KAR 5:006, Section 12, allows a customer to give notice of a change of address in person, in writing, or by telephone?

f. Sheets No. 9 and 10. Explain how the proposed accuracy of meters, specified as ± 3 percent, complies with 807 KAR 5:022, Section 8(3), which specifies that meters have an accuracy of ± 2 percent.

g. Sheet No. 10, Paragraph 24. How were the meter request test charges determined?

h. Sheet No. 11, Paragraph 27. Explain the purpose of this paragraph.

i. Sheet No. 21, Paragraph 44(e). How was the remote index installation charge of \$50.00 determined?

16. What is Gasco's current cost of gas?

17. How was the base rate on Sheet No. 22 determined?

18. How was the monthly service charge on Sheet No. 24 determined?

APPENDIX A
APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 94-427 DATED JANUARY 20, 1995.

HOLDING COMPANY GUIDELINES

REGULATORY CONCERNS

The competitive environment is changing in the electric and gas industries. ULH&P should be allowed to position itself to meet the changes and have the ability to meet increased competition for investor funds and investment opportunities. Unlike the holding companies created by the Louisville Gas and Electric Company and the Kentucky Utilities Company, the proposed reorganization of CG&E into CINergy involves the creation of a registered holding company. While there will be additional oversight by the Securities and Exchange Commission ("SEC") because CINergy will be a registered holding company, this Commission has certain concerns and objectives with regard to protecting interests of ULH&P's ratepayers. The concerns relate to three areas. First, utility resources should be protected. Second, the Commission should be able to adequately monitor the corporate activities of ULH&P, CG&E, CINergy, and CINergy's affiliates. Third, certain reporting requirements should be established to assist in the monitoring activities. The following conditions and requirements are necessary to ensure that the interests of the ratepayers are protected. Because many aspects of CINergy's or ULH&P's business activities under reorganization are unknown, and cannot be anticipated, flexibility should be maintained in the plans and procedures for monitoring CINergy's and ULH&P's activities.

PROTECTION OF UTILITY RESOURCES

Accounting Procedures and Controls

One of the Commission's primary concerns is the potential for cross-subsidization of non-jurisdictional activities by the jurisdictional company. Cross-subsidization can occur through misallocation of common or joint costs, or through improper pricing of intercompany transactions. Ensuring that cross-subsidization does not occur requires added regulatory oversight and increased focus on cost identification by CINergy, CG&E, and ULH&P. The potential cross-subsidization is most apparent in the areas of accounting, cost allocation methodologies, and pricing of intercompany transactions. If diversified activities increase, proper accounting and cost allocation methodologies will become even more important.

The accounting procedures are important in separating utility and non-utility costs. The original entries for expenditures are the most elementary aspect as most costs are direct charges and assignment to utility and non-utility operations can be accomplished through accounting controls and procedures which specify the treatment of certain elements of cost. The accounting and reporting system used by ULH&P should be adequate to provide assurance that directly assignable costs are accounted for properly and that reports on the utility and non-utility operations are accurately presented.

Adequate supporting documentation of costs for Commission review should be maintained whether those costs are generated at the ULH&P level or CINergy level. An in-depth review of the accounting systems has not been performed. Therefore, the approval

of the application in this case should not be construed as approval of the cost assignment procedures or of the proper method of separation of charges into utility and non-utility operations to be employed by ULH&P and CINergy.

The separation of costs through allocation methodologies is more subjective and requires greater scrutiny to ensure that cross-subsidization does not occur. CG&E and ULH&P have entered into a service agreement with CINergy Services, Inc. ("CINergy Services") which includes the cost allocation approaches for transactions between the parties them. While there currently is no separate service agreement between CG&E and ULH&P, such an agreement may be developed in the future. However, a detailed review of the allocation methodologies and procedures to be used by CINergy, CG&E, or ULH&P to separate utility and non-utility activities has not been performed during this proceeding. Consequently, no findings are made as to the adequacy of these procedures.

Application of cost allocation procedures present the greatest threat of misclassifications of utility and non-utility costs. As ULH&P's operations are monopolistic and its costs and earnings are regulated, it may be beneficial to CINergy to shift costs to the regulated operations allowing it to price its market-oriented services more competitively and provide greater returns to stockholders. Diversification is in the public interest only to the extent that utility operations are not adversely affected.

CINergy and CG&E have stated that because CINergy will be a registered holding company under the Public Utility Holding Company Act of 1935 ("PUHCA"), these concerns are alleviated by a number of provisions of PUHCA. Under PUHCA, the SEC limits the circumstances

and terms under which companies in a registered holding company system may perform services or construction for, or sell goods to, affiliated companies. These provisions contain a number of protections against cross-subsidization. CINergy and CG&E note that the service agreement with CINergy Services must be approved by the SEC. They have further committed that if a service agreement between CG&E and ULH&P is filed with the SEC, the Commission will have the same rights to accept or reject it as were extended to the Public Utilities Commission of Ohio.

The Commission accepts the assurances of CINergy and CG&E that its concerns in this area are addressed by PUHCA and the SEC. In future proceedings, it will be the responsibility of ULH&P to show that the allocation methodologies have not resulted in any cross-subsidization. As a part of that showing, ULH&P should be prepared to disclose fully all allocated costs, the portion allocated to each subsidiary of CINergy, complete details of the methods of allocation, and justification for the amount and the method.

The issue of cross-subsidization through pricing of inter-company transactions relates to the pricing of goods and services and establishment of prices for transfers of assets of the utility's assets. While CINergy and CG&E have stated that there are no definite plans for non-utility CINergy subsidiaries to transact business with ULH&P, the possibility does exist. Regarding the sale or transfer of assets, they note that affiliate transactions are subject to prior approval requirements of the SEC and that transfer pricing is required to be "at cost" under provisions of PUHCA and the SEC.

The Commission accepts the assurances and commitments of CINergy and CG&E that the oversight by the SEC under PUHCA will protect ULH&P's customers against cross-subsidization of non-utility activities. However, the accounting and other procedures and controls established by CINergy, CG&E, and ULH&P will be reviewed periodically, and in ULH&P proceedings as appropriate. When the policies and guidelines are modified or amended, ULH&P shall promptly file copies with the Commission.

Diversion of Management Talent

It is in the best interest of CINergy and its shareholders to secure the most skilled management available. While ULH&P will certainly share in the benefits of a well-managed corporate structure, diversion of management talent away from ULH&P to CINergy and its affiliates could threaten the continued efficient operation of ULH&P. This would not be in the best interests of the ULH&P ratepayers to whom continuity of management is important. CINergy and CG&E have stated that the operating management team for ULH&P will be the same as CG&E's, as is current practice, and may additionally draw upon the management talent pool existing at CG&E and CINergy. The Commission will monitor the composition of ULH&P's management team on an on-going basis.

Financial Resources

In the future, CINergy may be tempted to divert ULH&P's financial resources to support the activities of non-regulated affiliates at the expense of utility ratepayers. The Commission's objective is to minimize the risk which arises from CINergy's control of ULH&P's financial resources.

There are four main concerns regarding the insulation of ULH&P's financial resources from increased risks and the exposure of ULH&P to increased costs of capital stemming from those risks.

First, attempts by CINergy to adjust ULH&P's capital structure could adversely affect ULH&P's cost of capital and financial integrity. CINergy should assist ULH&P in maintaining a balanced capital structure.

Second, the dividend policy of ULH&P could adversely affect its financing requirements and capabilities to the detriment of its ratepayers. The larger the cash dividend ULH&P pays to CINergy, the greater the need for capital that must be raised externally. External financing could adversely affect ULH&P's cost of capital. Therefore, ULH&P through its board of directors, has the responsibility to use its dividend policy consistent with preserving the financial strength of the utility.

Third, an unwillingness on the part of CINergy to provide necessary capital to ULH&P could severely impair ULH&P's ability to provide utility services, consistent with its statutory obligation. Any action or decision by the board of directors of CINergy, including the unwillingness to provide adequate capital to ULH&P, that in any way impairs ULH&P's ability to provide adequate, efficient, and reasonable utility service, will be in direct violation of KRS 278.030(2).

Finally, guaranteeing debt of non-utility affiliates or CINergy by ULH&P could unnecessarily jeopardize the financial position and resources of ULH&P. ULH&P, pursuant to KRS 278.300, is prohibited from guaranteeing debt without prior Commission approval.

CINergy and CG&E have stated that the SEC under PUHCA protects the financial integrity of subsidiary companies in a registered holding company system. They note that many of the concerns expressed by the Commission relate to transactions where prior authorization from the SEC is required. While the SEC's regulatory oversight certainly provides some degree of protection to ratepayers, the SEC was created to protect investors, not ratepayers.

For rate-making purposes, the Commission has jurisdiction over ULH&P's capital structure, financing, and cost of capital. Through this authority, the Commission can protect ratepayers from the financial effect of non-utility activities. No new debt, preferred stock, or common equity can be issued without our prior approval. This prevents significant deviations from the approved capital structure, which is the key to ensuring that ULH&P maintains its financial integrity. Supplementing this financial control, the Commission must approve any guarantee of debt obligations by ULH&P for CINergy and its affiliates.

Employer/Purchaser of Last Resort

There is a risk that ULH&P could be used as the "dumping ground" for employees, assets, and products associated with failed or troubled affiliate ventures. ULH&P's strength and stability could tempt CINergy or its affiliates to use ULH&P as the employer or purchaser of last resort. ULH&P has assured the Commission that its management is committed to maintaining the highest caliber of managerial, technical, and other capabilities and to ensure that materials, supplies, and services are acquired in the most cost-effective manner. ULH&P has acknowledged that the Commission will

maintain complete oversight of utility operations and will be able to ensure that inappropriate transfers or purchases from an affiliate are not made. The Commission will monitor ULH&P's activities to assure the ratepayers that "dumping" has not occurred.

Divestiture

The Commission must also consider the potential of a failed or failing unregulated affiliate and its affect on the operations of ULH&P. If future circumstances dictate that the only reasonable course of action is divestiture, including that of the utility, it will be the responsibility of ULH&P's management, as those charged with the well-being of the dominant subsidiary, to ensure that divestiture takes place.

MONITORING CINERGY AND THE SUBSIDIARIES

In consideration of the regulatory safeguards necessary in cases of utility reorganization, the most indispensable requirement is open access to all books, records, and personnel of CINergy and each subsidiary. It is imperative that the Commission have the ability to pursue any problems perceived in the operations of the utility through access to the books and records to CINergy and affiliates. During formal proceedings, the Commission may also choose to cross-examine personnel of the unregulated entities if necessary to monitor effectively the relationship between ULH&P and its parent and affiliates.

CINergy and CG&E have noted that the Commission will have access to the accounts and records of CINergy Services under the terms of the service agreement. They have stated that they will provide the Commission access to the books and records of CINergy

and its affiliates and subsidiaries. However, where CINergy does not own a controlling interest in an affiliate or subsidiary, it may be difficult if not impossible to provide access. CINergy and CG&E proposed to define an affiliate or subsidiary of CINergy or CG&E as a corporation in which CINergy or CG&E owns directly or indirectly or in combination with its other affiliates or subsidiaries 50 percent or more of the corporation's voting capital stock.

This definition is acceptable, with one modification. If less than 50 percent of the corporation's voting capital stock is owned by CINergy or CG&E, but they possess, directly or indirectly, the power to direct or cause the direction of the management and policies of a company, whether such power is exercised through one or more intermediary companies, or alone, or in conjunction or pursuant to an agreement, then CINergy or CG&E will be deemed to have control. This is the definition of control contained in the Federal Energy Regulatory Commission's Uniform System of Accounts (18 CFR Ch. 1, Subchapter C, Part 101).

Therefore, the Commission will have access, as necessary in the exercise of its statutory duties, to the books and records of CINergy and its other affiliates and subsidiaries as the books and records may be related to transactions with ULH&P. If the subsidiaries or affiliates of CINergy do not transact business with ULH&P, ULH&P will verify, if necessary, the lack of such transactions through independent sources.

CINergy and CG&E have indicated that they have no present plans to transfer any assets nor have they identified non-utility activities in which CINergy will participate. To ensure the full

protection of ratepayer interests, it will be necessary to monitor significant transfers of utility assets, business ventures of CINergy, and other major transactions. As there is the potential that these and future actions may have a significant impact on the ratepayers, these should be reviewed by the Commission at the time they are completed.

REPORTING REQUIREMENTS

In order for the Commission to monitor effectively the activities of ULH&P, CINergy and its related subsidiaries, and protect ratepayers, certain additional reports shall be furnished by ULH&P to the Commission on an annual, periodic, or other basis as appropriate.

Periodic Reports

ULH&P should furnish the annual financial statements of CINergy including consolidating adjustments of CINergy and its subsidiaries with a brief explanation of each adjustment and all periodic reports filed with the SEC. All subsidiaries should prepare and have available monthly and annual financial information required to compile financial statements and to comply with other reporting requirements. The financial statements for the non-consolidated subsidiaries of CINergy should be furnished to the Commission.

CINergy and CG&E have agreed to and should file on a quarterly basis a report detailing ULH&P's proportionate share of CINergy's and CG&E's total operating revenues, operating and maintenance expenses, and number of employees.

CINergy and CG&E have agreed to and should furnish the following reports on an annual basis:

1. A general description of the nature of intercompany transactions with specific identification of major transactions, and a description of the basis upon which cost allocations and transfer pricing have been established. This report should discuss the use of the cost or market standard for the sale or transfer of assets, the allocation factors used and the procedures used to determine these factors if they are different from the procedures used in prior years.

2. A report which identifies professional personnel transferred from ULH&P to CINergy or any of the non-utility subsidiaries and describe the duties performed by each employee while employed by ULH&P and to be performed subsequent to transfer.

Special Reports

Other special reports should be furnished to the Commission as necessary. It is realistic to anticipate that transfers of utility assets and investments by CINergy will occur in the future. CINergy and CG&E have agreed to file any contracts or other agreements concerning the transfer of such assets or the pricing of intercompany transactions with the Commission at the time the transfer occurs.

CINergy and CG&E should provide the following information:

1. A quarterly report of the number of employees of CINergy and each subsidiary on the basis of payroll assignment.

2. An annual report containing the years of service at ULH&P and the salaries of professional employees transferred from ULH&P to CINergy or its subsidiaries filed in conjunction with the annual transfer of employees report.

3. An annual report of cost allocation factors that would be in use supplemented upon significant change.

4. Summaries of any cost allocation studies when conducted and the basis for the methods used to determine the cost allocation in effect.

5. An annual report of the methods used to update or revise the cost allocation factors in use, supplemented upon significant change.

6. Current Articles of Incorporation and bylaws of affiliated companies which would be in businesses related to the electric or gas industry or that would be doing business with ULH&P.

7. Current Articles of Incorporation of affiliated companies involved in non-related business.

Concerning the first item, CINergy and CG&E had requested the Commission to limit this information to the number of employees of CINergy, CG&E, CINergy Services, ULH&P, and non-utility affiliate companies. They stated that this information and the report of transferred professional personnel should be sufficient to satisfy the Commission that ULH&P was not used as a "dumping ground." However, only by viewing the total CINergy employment picture will the Commission be able to satisfy its concerns that ULH&P has not become an employer of last resort.

Where the same information sought in these reports has been filed with the SEC, CINergy, CG&E, or ULH&P may provide copies of the SEC filings rather than prepare separate reports. Further, CINergy, CG&E, or ULH&P may request the Commission to review these reporting requirements after the merger is completed to determine

if the documentation being provided is either excessive or redundant.